LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS
200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7094 | **NOTE PREPARED:** Jan 12, 2003
BILL NUMBER: HB 1763 | **BILL AMENDED:**

SUBJECT: Business Investment Tax Incentives.

FIRST AUTHOR: Rep. Espich | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: This bill eliminates the 30% floor on the total property tax value of a taxpayer's depreciable personal property. The bill exempts purchases for research and development from Gross Retail and Use Taxes. The bill also provides that, for purposes of the Adjusted Gross Income Tax, business income is apportioned based on the sales factor. The bill eliminates the property factor and payroll factor that are currently also used in apportioning income. The bill also makes the Research Expense Credit permanent.

Effective Date: July 1, 2003; January 1, 2004.

Explanation of State Expenditures: *Personal Property Assessments*: The state pays Property Tax Replacement Credits (PTRC) in the amount of 60% of school general fund levies attributable to all property and 20% of the portion of all operating levies (including the remaining 40% of the school GF levy) that are attributable to real property and non-business personal property. Homestead Credits are paid by the state in the amount of 20% of the net property tax due on owner-occupied residences.

The tax shifts from business personal property to other property in the bill would cause the state's expense for regular PTRC and Homestead Credits to increase. PTRC and Homestead Credits are paid from the Property Tax Replacement Fund, which is annually supplemented by the state General Fund. Therefore, any additional PTRC or Homestead Credit payments would ultimately come from the state General Fund. The additional state expense is estimated at $4.7 M in FY 2005 (partial year) and $14.4 M in FY 2006. This amount will grow by about 5.3% per year.

Department of State Revenue: Changes in the income tax apportionment formula will create additional administrative expenses for the Department of State Revenue to change tax forms, instructions, and computer programs. These expenses should be covered under their current budget resources.

Explanation of State Revenues: *Income Tax Apportionment Factors*: Due to the recent corporate tax restructuring provisions in P.L. 192-2002ss, it is difficult to estimate the impact of this proposal. This bill will reduce Corporate Adjusted Gross Income Tax by an indeterminable amount beginning in FY 2004. Under the current statute, a company that conducts business in other states uses a three-factor formula to determine their Indiana Corporate Adjusted Gross Income Tax liability. The formula utilizes property, payroll, and sales to allocate business income to the state. The current formula is the following:

$$\left[\frac{\text{Indiana Property}}{\text{Total Property}} + \frac{\text{Indiana Payroll}}{\text{Total Payroll}} + 2\left(\frac{\text{Indiana Sales}}{\text{Total Sales}}\right) \right] / 4$$

This bill would eliminate the property and payroll factors in the apportionment formula along with the double weighting of the sales factor. The amount of a company's adjusted gross income would be determined by a single-factor formula which measures the percentage of Indiana sales to their total sales. The new formula would be the following:

$$\frac{\text{Indiana Sales}}{\text{Total Sales}}$$

The change in the apportionment formula, as proposed by this bill, would decrease corporate income tax liabilities by an indeterminable amount. This bill is effective for the tax year beginning January 1, 2004, and would impact revenue collections starting in FY 2004 due to adjustments in estimated quarterly payments. The December 18, 2002, Revenue Forecast estimates Corporate Income Tax revenue collections to be $560.5 M in FY 2004 and $580.6 M in FY 2005.

Corporate income taxes are deposited in the General Fund.

R & D Sales Tax Exemption: This bill creates a broad Sales Tax exemption on the purchase of tangible personal property used for research and development. Based on adjusted data from the National Science Foundation, it is estimated that this Sales Tax exemption could reduce state revenue by $48.4 M in FY 2004 and $54.6 M in FY 2005.

Sales Tax revenue is deposited in the Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Loan Fund (0.033%).

Research Expense Credit: This bill makes the Research Expense Credit permanent. It is currently set to expire December 31, 2004. It is estimated that these changes will result in an additional revenue loss beginning in FY 2005 and years after.

Over the past few years, the current Research Expense Credit has ranged from $9.2 M in FY 1996 to $24.2 M in FY 1999. However P.L. 192-2002ss increased the credit to 10% and eliminated the apportionment formula. Consequently the cost of the base credit was estimated to increase by an additional $47.9 M in FY 2004 and $51.5 M in FY 2005 (for a full 12 months or $24.8 M for 6 months due to the expiration of the credit in 2004). The total annual cost of the current credit is estimated to be $72.1 M in FY 2004 and $75.7 M in FY 2005. If this credit were to expire December 31, 2004, the revenue base could potentially increase by approximately $37.85 M in FY 2005 (six months liability) and $79 M in FY 2006. However, without this credit available, taxpayers' investment in research activities could significantly change and affect their base income tax liabilities. Research Expense Tax Credits affect revenue collections deposited in the General Fund.

It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

Personal Property Assessments: The state levies a tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. The annual revenue reduction under this proposal is estimated at about $25,000 in FY 2005 and $50,000 in years following.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Personal Property Assessments*: Under current regulations, the total value of a taxpayer's depreciable property located in the same tax taxing district must be at least 30% of the total cost of the property. This is known as the 30% valuation floor. This bill would remove the floor beginning with March 1, 2004, assessments for property taxes paid in CY 2005.

The removal of the floor would reduce the assessed value of personal property which would shift part of the tax burden from personal property taxpayers to all property taxpayers. The following table contains the estimates of tax shifts in CY 2005 based on examination of data from returns with over $150,000.

Estimated CY 2005 Property Tax Shifts
30% Floor Removal

Property Type	% Shift	Tax Shift *
Agricultural	1.3%	5.2 M
Residential	1.8%	36.7 M
Commercial	-0.1%	-2.0 M
Industrial	-3.0%	-26.4 M
Utility	-13.3%	-27.7 M
PTRC		5.0 M
Homestead Credit		9.2 M
Total Change		0.0

* A positive tax shift represents an increase in property tax liability.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue.

Local Agencies Affected:

Information Sources: Local Government Database; National Science Foundation; Department of State Revenue.

Fiscal Analyst: Diane Powers, 317-232-9853; John Parkey, 317-232-9854; Bob Sigalow, 317-232-9859.